IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-1075

Supreme Court, U. S.
FILED
MAR 31 1972
MICHAEL RODAK, JR., CLERK

JACOB FERSHTMAN, HAROLD SIEGEL, ISABEL WEST, ZITA GARFIELD, LARRY SOMMA, HYMAN FREYDBERG, RENA KLEIN, JACOB KRIVILOFF, AGNES SHOEMAKER, as Executrix of the Estate of ROBERT SHOEMAKER, individually and as Limited Partners of PENN ASSOCIATES, a New York Limited partnership,

Petitioners,

-against-

HERMAN J. SCHECTMAN, SIDNEY P. SCHECTMAN, JOHN D. BUSSEL, HENRY SPELLMAN, GEORGE ZUCKERMAN, individually and as General Partners of PENN ASSOCIATES, PENN ASSOCIATES, 461-8TH AVENUE CORPORATION, ROSE W. GROSS, as Executrix of the Estate of SIMEON F. GROSS and ELLIOT S. GROSS, co-partners doing business under the firm and style of "Simeon F. Gross and Elliot S. Gross", ROSE W. GROSS as sole distributee of the Estate of SIMEON F. GROSS, ELLIOT S. GROSS and ARTHUR YOUNG & COMPANY,

Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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ARGUMENT

A. The Much Criticized Holding of *Birnbaum v. Newport Steel Corp.*,[1] Should Be Finally Laid to Rest.

The Court of Appeals concluded its decision by affirming the District Court's dismissal of the complaint on the ground

petitioners were not "forced sellers", by virtue of "their refusal to sign papers evidencing the return of their capital and their share of the profits." (Petitioners' Appendix A, p. 8a)[2] The purchaser-seller doctrine enunciated by said Court in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), cert. denied 343 U.S. 956 (1952), on which the Court below relied, is unfortunately still very much alive. In a more recent decision District Judge Gurfein in the Southern District of New York, upon reviewing the "*Birnbaum*" doctrine in *Haberman v. Murchison*, 335 F. Supp. 286 (S.D.N.Y. 1972) concluded "[a]ccordingly, Birnbaum is left where it was" (at p. 289).

The Securities and Exchange Commission filed an Amicus brief in the Eighth Circuit (February 23, 1972) in *Travis v. Anthes Imperial Ltd.*, in asking for an abandonment of the "*Birnbaum*" doctrine, urging an "approach far more certain to assure consistent vindication of the Congressional purposes would be outright rejection". (Securities Regulation & Law Report, the Bureau of National Affairs, Number 141, p. A-2 March 1, 1972). The S.E.C. urged the Eighth Circuit to "take this opportunity unambiguously to reject the Birnbaum doctrine", as arbitrary that results in hardship. Surely, *Birnbaum* cannot survive in the light of this Court's analysis of the Congressional intent in *Superintendent of Insurance of the State of New York v. Bankers L. & Cas. Co.*, 404 U.S. 6 (1971).

This case further demonstrates the need for interment by this Court of the *Birnbaum* "purchaser-seller" doctrine. As we pointed up in our Petition, the Circuit Court assumed facts which were not true, since four (4) of the petitioners did sign papers, received their capital and thereby were "forced-sellers" by the Court's requirement (Pet. App. A, p. 8a). The respondents have not denied in their opposing briefs that the Circuit Court erroneously based its opinion on this assumed fact. Furthermore, analysis of respondents' brief — wherein

they seek to have it both ways — patently demonstrates their concession that this case turns on whether respondents' resultant ownership of the lease came about from the "forced-sale" of the limited partners' interests.

B. Respondents' Counter-Statements of Facts are Untrue, Distorted and Merely Arguments of Counsel.

In an attempt to bolster their case, respondents have indulged in incorrect and distorted misstatements of facts not justified by the record. In many instances argument is substituted for facts; calculated to divert the Court's attention from the gravamen of petitioners' complaint (¶¶ 29-32, Res. App. A, pp. 12a-13a),[3] that the general partners' activities complained of constituted a "forced-sale" of the limited partners' interests. Respondents seek to have this Court condone their breaches of fiduciary obligation[4] by speaking of "redemption" [15a][5] of the limited partners' interest as if it were a debenture and the relationship of the general partners to the limited partners was that of debtor and creditor. This Court should reject these misstatements, misrepresentations and arguments under the guise of "facts". Examples of these distortions and misstatements are footnoted hereafter.[6]

C. Respondents Raise Issues for the First Time in This Court.

On March 29, 1968 the general partners mailed to the limited partners the notice of termination of the partnership. It was the declaration and mailing of this notice which petitioners claim constituted the "forced-sale" as alleged in ¶¶ 29-32 of the complaint (Res. App. A, pp. 12a-13a). For the first time in this Court respondents raise the argument that the complaint does not allege the sales "were made by means of interstate commerce or the mails" [10a].

The complaint (¶ 2, Res. App. A p. 2a) alleges the cause of

action arose under Section Nos. 12(2) and 17(a) of the Securities Act of 1933 as amended and Section 10(b) of the Act of 1934 and Rule 10b-5.

Section No. 12(2) of the Securities Act of 1933 besides permitting a recovery for damages to the person purchasing a security even "if he no longer owns the security" gives rise to such cause of action against one who offers or sells a security by the use of interstate commerce, or the mails which language is also contained in Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5. (Petitioner's Petition for a Writ of Certiorari, pp. 3-4). Alleging these sections are a sufficient allegation of the provisions contained therein, Respondents' objection is not well taken.

D. Respondent Arthur Young & Company Aided and Abetted the General Partners' Fraudulent Conspiracy.

Arthur Young & Company, the general partners' accountants, from the inception of the transaction, aided, abetted and helped mastermind the fraudulent conspiracy to appropriate and convert the lease. Examples of some of the things which aided and abetted the general partners are they signed United States corporate income tax returns under penalty of perjury that Simeon F. Gross, the president of the corporate defendant was the 100% owner of all of its stock when they knew he wasn't; they siphoned off the tax benefits of the amortization of the leasehold acquisition and depreciation of improvements and violated the operational agreement to give respondents all of the tax benefits. They failed to disclose that the lease had been extended in their schedules prepared for and attached to the defendants' March 29, 1968 unilateral declaration of termination of the partnership, which schedules the general partner used to give authenticity to by the use of Arthur Young & Company's prestigious name. Moreover, the record is replete with facts indicating why the complaint should not have been

dismissed against this particular and equally culpable respondent.

CONCLUSION

The petition for a writ of certiorari should be granted.

In addition, petitioners respectfully suggest that summary reversal may be in order in the light of the erroneous assumption by the Court of Appeals that all of the petitioners were not "forced-sellers."

Respectfully submitted,

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March 31, 1972

Footnotes

1. 193 F.2d 461 (2d Cir. 1952), cert. denied 343 U.S. 956 (1952).

2. Petitioners' Appendix hereafter referred to as "Pet. App." refers to the appendices to the Petition for Writ of Certiorari.

3. Respondents' Appendix hereafter referred to as "Res. App." refers to the Appendices to Respondents other than Arthur Young & Company's brief.

4. The damages of $2,000,000 sought to be recovered for the partnership was not "plucked from the atmosphere" but is alleged as the value of the lease. (Pet. App. A, p. 5a).

5. All references in brackets are to pages in respondents' brief.

6. (a) Respondents argue, "[t]he leasehold was owned by the respondent corporation" and Penn Associates, "was formed in 1956 to manage the leasehold of premises known as 461 - 8th Avenue" [p. 3a] Title of the leasehold was not in the respondent corporation at the time the limited partners were invited to participate in the venture. No written prospectus outlining the transaction was ever furnished the limited partners prior to the call for their capital. When the partnership agreement was presented to the limited partners for signature on May 5, 1956 it was not disclosed to any limited partner that a closing was going to take place on Monday, May 7, 1956, or that at the closing the general partners would cause the ownership of the leasehold to be taken in the corporate defendants' name. Nor, were any other facts in connection with the acquisition of the lease disclosed to the limited partners, which the general partners admitted on their deposition.

Contrary to respondents' contention the Court of Appeals found that Penn Associates was formed "for the purchase of a lease", (Pet. App. A, p. 2a) rather than merely to manage it.

(b) Respondents state "[t]he limited partnership agreement of Penn Associates, dated May 4, 1956, a copy of which is annexed to the complaint in this action and appears in the appendix hereto as Appendix B at pages 17a-34a" is a misstatement of fact calculated to mislead this Court [3a] on one of the principal contested issues in this litigation. Attached to the complaint is a copy of the limited partnership agreement (Res. App. B, pp. 17a-28a). The operational agreement (Res. App. B, pp. 29a-34a) was not attached to the partnership agreement when petitioner signed it and was never disclosed nor seen by them until it was begrudingly elicited from the respondents after the Kaine action had been instituted. The reference to the corporate defendant in the partnership agreement (¶ 13 - Res. App. B, p. 24a) without disclosure of respondents involvement created the inference that 461 - 8th Avenue Corporation was from whom Penn Associates was purchasing the lease.

It is undisputed this operational agreement was not in existence prior to May 4th and it had not been shown or disclosed to any of the limited partners prior to the payment by them of their capital contribution or the institution of the Kaine action. The respondents' appendix in its head title on pages 29a-34a misrepresents and misleads that this operational agreement between Penn Associates and the respondent corporation is part of the limited partnership agreement attached to plaintiff's complaint.

(c) Respondents argue there was "no reason to tell the limited partners the lease had been extended"[6a]. This contention is contrary to the Congressional intention in enacting the Federal Securities Laws which require disclosure to

prevent those in control or in a fiduciary position to participate in self-benefitting transactions at the expense of their beneficiaries.

(d) Respondents' contention that the general partners did not undertake to sell the lease [7a], even if true, does not license the general partners to appropriate and convert the partnership assets by manipulative devices. However, this contention is inconsistent with the general partners' fiduciary obligation to turn the assets of the partnership into a profit for all, rather than use the partnership as a vehicle for their unjust-enrichment. As noted in item (H) *infra*, ¶ 13 of the partnership agreement provides that the general partners may extend the lease but it does not state that the lease would belong to the general partners as a result of their unilateral declaration of the termination of the limited partnership before the expiration of the lease which had over 3-1/2 more years to go at the time the general partners appropriated and converted the leasehold.

(e) Respondents contention that petitioners knew the stock of the corporate defendant was held for the general partners intends to mislead this Court [7a]. Petitioners did not know of the existence of the corporation and so allege in their complaint (¶¶ 17-20, Res. App. A, pp. 5a-7a).

(f) The May 14, 1956 letter from respondent Schectman to Kaine (Pet. App. C, p. 19a), assuring him "that the general partners can only pay off the limited partners in the event that the leasehold of the office building is sold" supports petitioners' contention that ¶¶ 6, 8 and 14 are mutually supporting and should be interpreted that the partnership could not be terminated as long as the venture had an interest in the lease or until the lease was sold. The possibility of a capital gain sale, thereby converting ordinary income to capital gain resulting

from increased rents, was one of the prime inducing motives for the petitioners to become limited partners. Otherwise, why would paragraph 14(c) have been inserted in the partnership agreement (Res. App. B, p. 25a) providing for the distribution of capital gain upon a sale? Additionally, evidencing that intention, ¶ 7(a) of the operational agreement (Res. App. B, p. 33a) makes similar provision for the distribution of capital gain. Since the respondents had control of the entire transaction, any doubts as to the meaning of this representation should be resolved against the respondents.

(g) The argument that the release of the parking lot in whose income the limited partners shared, was inconsequential since the general partners personally guaranteed the limited partners a return of 12% on their outstanding capital has no validity. [6a] ¶ 13 of the partnership agreement only requires that the limited partners be paid 12% if there is a modification of the rental whereby the limited partners receive less than 12%. However, where the limited partners are receiving 12% of their capital and rental income is released by the general partners, it reduces the limited partners' share of the profits in excess of 12%. If the complaint does not mention the release of the parking lot, it is because it need only plead ultimate facts. The allegations of a single fraudulent conspiracy to self-benefit the respondents at the expense of the limited partners, by the appropriation of the lease covers the presentation of the facts of the release of the parking lot to the owner of the fee to obtain the 20-year extension of the lease.

(h) Petitioners have no quarrel with the contention that ¶ 13 of the partnership agreement (Res. App. B, p. 24a) gave the general partners the right to extend the lease [4a]. Petitioners' complaint is the extension of the lease was obtained while the partnership was in existence, by releasing partnership property with attendant reduction of rental which petitioners

shared and not for the benefit of the partnership but as a preliminary step to its conversion and appropriation by the general partners by the termination of the partnership. ¶ 13 of the partnership agreement read in conjunction with ¶ ¶ 6, 8, 14 and the letter dated May 14, 1956 (Pet. App. C, p. 19a) must be interpreted if the lease had been sold or the leasehold expired the general partners were not obligated to continue the partnership by further utilization of the funds realized to make other investments.

(i) The events surrounding the formation of the partnership in the early part of May, 1956 conclusively indicate, contrary to respondents' denial, that the execution of the limited partnership agreement was a hurried affair [5a]. The partnership agreement and certificate of limited partnership are both dated Friday, May 4, 1956. They were signed by all of the limited and general partners, either on Saturday, May 5th, or Monday, May 7, 1956. Execution of said documents by the limited partners was rushed over the weekend on the pretext they would lose the deal or a month's rent (closing paragraph, Pet. App. C, p. 20a). The real reason, however, was the closing for the purchase of the lease had been scheduled by the general partners for May 7, 1956. Since the general partners instead of providing their agreed capital contribution had arranged with the Irving Trust Company, to lend the partnership $300,000, to be applied on account of their capital contribution the bank required that a formal limited partnership agreement be first filed in the County Clerk's office as required by New York Law to give legal existence to the partnership before it would make the loan.

(j) Petitioners claim that when their capital contribution was requested on either the first, second or third of May, it was represented to them that all partners, including the general partners, were making their capital contribution. The

respondent Herman J. Schectman corroborated this on his deposition.

> "After all, the partners made a substantial investment.
>
> "He (Kaine) said, 'if you make an investment, Herman, I will make the investment'."

Said deposition contradicts respondents' counsel's claim that "[n]o representation was made to any limited partner that the general partners had cash to put into the venture" [5a]. And, so, it can be understood that under the hurried conditions where the partnership agreement was brought by messenger to the homes of Kaine and other limited partners, for signatures, on Saturday, May 5, with the exhortation not to delay the messenger making the round, at which time they were not represented by counsel and had no opportunity to discuss or question the partnership agreement, the language of ¶ 15 (Res. App. A, p. 25a), that the general partners could pledge the assets of the partnership was something that had never been discussed beforehand and had reference to the future, the general partners having represented a few days before all of the partners including themselves were contributing their cash capital.